

Realty Stock Review

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MARKET STRATEGY: REMEMBER HOUSING'S ROLE AMID THE MARKET'S SLOWER-GROWTH HYPE

The herd instinct among investors never ceases to amaze. Last Monday several respected analysts saw slower second half growth ahead and, presto, the Dow-Jones Industrials dived 62 points.

Market reaction by housing and realty stocks was swift. Manufactured housing stocks fell 12.1% in the last two weeks (table, p.4); major homebuilders dipped 4.1%, and other builders dropped 4.5%. About two-thirds (81) of our 123 operating company stocks fell in this tide, while 28 managed gains. All this despite housing's historic role of leading the economy out of recessions. Slower growth forecasts should be positive for these groups, not negative.

REITs fared much better, our four REIT groups falling about 1% vs. a 2.9% dip in the DJI. Less than half (43) of the 95 REITs fell and over one-third (32 stocks) gained. This despite dire predictions, emanating from real estate and mortgage lender groups, that passage of the proposed tax bill with its limits on real estate tax shelters would lower property values by 20%-30% or so.

We see very uneven value changes. Many oil patch properties have fallen

30%-50% or more already, due to plummeting oil prices more than tax law changes. Properties with weak occupancies traced to overbuilding are off 10%-30%. Stronger properties with good occupancies, especially in the Northeast, are little touched. Longer-term, we see higher rents and values for most properties as tenants pay the return which Uncle Sam subsidized via tax shelters.

Names of stocks moving against the tide are especially useful in such times, since contrary action oftentimes signals ongoing strength. Since our computerized tables aren't published this issue, we mention some notable stocks. Among homebuilders, **Kaufman & Broad** rose 3.9%; it is offering shares of its homebuilding subsidiary as a separate issue. **U.S. Home** stock rose 1.9% as the market greeted news of restructuring and writeoffs positively; **UH** is reviewed inside.

In a weak realty services group, **Equitec Financial Group** rose 7.1% and **Hallwood Group** advanced 6.4%. **HWG**, which is recycling realty assets into merchant banking for troubled companies, announced it is talking to two oil patch banks about restructuring them; one later accepted another offer. **Ameribanc Investors**, formerly a REIT, rose 8.2% on takeover news. Investment built (Turn page)

RANKING REVIEW ISSUE

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der **Rouse Co.** rose 0.6%, **Koger Co.** was up 0.9%, and **Forest City Enterprises**, reviewed inside, fell 2.0%.

Standouts among REITs were those leasing health care facilities at attractive yields. **Meditrust** rose 6.9% on a planned \$100 mil. stock offering to provide additional investment funds. **Beverly Investment Properties** rose 3.7% to a new high on news it agreed to buy 18 additional long-term facilities from sponsor **Beverly Enterprises**. **Health Care Properties** was up 3.8% on news a 50% owned partnership was buying eight convalescent facilities from an unaffiliated operator. **Health Care REIT** and **Healthvest** (RSR, June 27) also rose.

RANKING REVIEWS: FOREST CITY ENTERPRISES HOLDS RANK; U.S. HOME LOWERED IN REVIEW

Forest City Enterprises Inc. (\$30.50 Cl. A; \$30.63 Cl. B - ASE) holds B Rank in our review. This Cleveland-based real estate and retailing company recently sold \$40 mil. of 7.25% debentures convertible into Cl. A shares at \$38.25; full conversion would amount to about 20.5% of the class and cut the controlling Ratner family stake from about 66% to 52.5%. The Ratner family continues to own 69% of Cl. B shares, which elect 75% of directors.

EPS/Dividends - B: FCE earned 94¢ in its Jan. 1986 fiscal year, including 22¢ gain on property sales from wholly owned (but unconsolidated) **Forest City Rental Properties**, its property development and ownership subsidiary. The 72¢ operating income was up 47%. FCE considers cash flow its most important measure of performance and reported operating net cash flow of \$2.72/sh. in 1986, up 20%; FCE includes \$1.23/sh. deferred income taxes in its cash flow computations, but Audit subtracts these deferrals in its statistical tables. FCE earned 16¢ sh. in the April qtr., including 13¢ property sale gains, vs. 10¢. FCE increased payout on Class A shs. to 30¢ annually in 1985.

Assets and Operations: FCE began redirecting its energies four years ago into becoming a vertically integrated real estate development and investment company seeking to invest in interme-

diate to large size urban projects where locations, design, and financing provide unique opportunities for appreciation. In doing so FCE has become a major player in developing multi-use urban projects which often require close cooperation with cities, institutions, and communities. Its only counterpart among public companies is Rouse Company, which stresses retail centers while FCE projects normally contain more residential and office space. In the last four years FCE has sold \$273 mil. of smaller projects, mostly shopping centers and apartments, and invested \$369 mil. in major urban projects which it believes have very long term (25-50 years) values. During FY 1986 FCE added:

Millender Center, Detroit: hotel, retail and apartments, subsequently sold for \$119 mil. to a partnership.

South Bay Galleria, 945,000 sq. ft. enclosed mall in Redondo Beach, Cal., including 345,000 SF mall owned 100% by FCE.

Halle Building, 380,000 SF former Cleveland department store building renovated into retail/office.

During FY 1987 FCE will add seven major properties, including mall shopping centers in Arlington, Va. and Victorville, Cal; expansion of a mall in Flint, Mich.; mixed-use project in Pittsburgh; one office and two apartment projects. FCE already owns interests (generally 50%) in 13 regional malls with 10.0 mil. SF; two hotels; four mixed use and office projects; and 9,057 apartments.

FCE Rental Properties generated \$1.75/sh. net cash flow (\$13.9 mil.) from operations in 1986, and deferred another \$1.23/sh. of federal taxes. Revenues rose 14% to \$108 mil.

Other operations: FCE markets home improvement products thru 18 retail stores in Cleveland, Akron and Detroit (11 stores are leased from Rental Properties); some stores have been reformatting to a modified warehouse plan to meet stiff competition. Retail stores generated \$159.3 mil. sales, up 15% on a comparable store basis, and \$1.44 mil. pretax profit last year. Five Chicago stores were sold in the year. A separate Credit Corp provides credit card and installment financing for retailing

customers, and generated \$1.4 mil. pre-tax profit. FCE also is active in merchant building and land development, building many of Rental Properties' holdings using a patented modular concrete building system when possible. This unit lost \$5.25 mil. pretax in 1986, largely because of substantial losses in building an Ohio prison. A Land Group develops and sells land in bulk; \$20.6 mil. sales were breakeven. FCE owns 6,000 acres in six states with \$41.9 mil. carrying cost, and is stressing disposition of Ohio land for purchases of land in other cities.

Financing - B: Total debt and advances from affiliates was \$105.5 mil. at the parent company level pro forma the convertible offering, or 1.5 times shareholders' equity of \$70.4 mil. In addition Rental Properties has \$426.5 mil. of debt, nearly all non-recourse mortgages secured by properties. After Audit adds back real estate depreciation of \$77.2 mil. to equity, adjusted total equity of \$147.6 mil. equals \$18.57/sh. Pro forma book value full converted is \$20.85/sh. While FCE doesn't estimate current value of its assets, we believe that in the real estate world Rental Properties' \$23.7 mil. net cash flow (including deferrals) would be capitalized at 8%-10% and FCE is thus worth about \$34-\$42 per share.

Exposure - B: While FCE's leverage is high by traditional accounting standards, FCE is a seasoned and successful real estate developer with a long track record. It is seeking to develop a portfolio of major urban properties with some insulation from competition because of their location, design and financing. FCE has succeeded so far by rigorous control of costs and judicious financing, often including urban renewal seed funds and tax exempt debt. The major risk is in pioneering locations that are too early for strong market acceptance. If FCE succeeds in developing a unique portfolio, in time the implicit cap rate on its properties could be much lower.

U.S. Home Corp. (\$7 - NYSE) is cleaning house under new management to return UH to profitability. While we regard the move as very positive, we are reducing our Ranking to C based upon somewhat

higher leverage for ongoing operations.

EPS/Dividends - C: UH lost 26¢ in 1985, vs. \$1.27 loss in 1984. March qtr. loss of 5¢ was half the previous year. To set operations aright, UH will set up \$70-\$80 mil. aftertax reserves (about \$1.90-\$2.20/sh.), which will result in June qtr. and full year losses. Management says the writeoffs should have negligible cash flow impact and expects second half cash flow to be positive. Dividends were discontinued in 1985.

Assets and Operations: Specifically UH's reserves on a pretax basis are for: (1) \$60-\$63 mil. reserves against \$67.8 mil. option deposits on Houston land owned by Homecraft Development Corp., a separate land development company in which UH has a \$5 mil. non-voting preferred investment; (2) \$40-\$44 mil. to close most Houston single-family tracts and limit Houston exposure (UH feels it was over-committed to Houston, which lost \$14.3 mil. and \$5.7 mil. pretax in 1985 and the March qtr. respectively); (3) \$20-\$23 mil. to close its Interstate modular housing and either close or sell all parts of Brigadier mobile home operations (they lost \$15.2 mil. and \$2.2 mil. pretax in 1985 and the March qtr. respectively). In addition UH will trim overhead selectively to save \$10 mil. on an annual basis (UH overhead has been about 2%-3% above industry averages).

UH will continue to operate in many growth markets, including Florida and New Jersey; discontinued operations accounted for 11% of UH's 8,800 home deliveries last year. And it will open 15 new tracts in California, which it regards as a hot housing market. Ex the closed operations, UH would have earned 21¢ in 1985 before accounting for any overhead savings which could be about 15¢ annualized.

Financial Measures - C: Total debt of \$433.7 mil. is about 1.9 times \$219-\$229 mil. shareholders' equity following the writeoffs. About \$300 mil. is long-term debt while the remaining \$133 mil. is short-term. UH's major lenders under a \$120 mil. revolving credit term loan and \$127.3 mil. credit agreement have supported the restructuring, which gives UH positive debt service coverage. "The stock may be under pressure but the

company is not at risk," management says. Stockholders' equity falls to about \$6.00-\$6.30/sh., which management says still makes UH one of the best capitalized homebuilders.

Exposure - B: UH couples the write-offs with a strategy of stressing building of presold homes, instead of building speculatively ahead of sales, and will seek to hold most land in joint ventures or under options with land owners or developers, thus adopting the style of **Ryland Group** or **Ryan Homes**. The change could cost UH sales in strong markets but reduces risk of unsold inventory (which has been halved since Dec.). UH will stress profitability of sales, not market share or unit volume. The change may speed asset turnover. UH has clearly given up being a major player in Houston, where it once was the biggest builder (other Houston-based builders said it is unfair to blame all UH's troubles on Houston and note that **General Homes** and **Gemcraft** have been selling strongly there). While we've lowered UH's Rank, this writeoff makes speculative commitments attractive.

NEWS REVIEWS: AMERIBANC INV. TO JOIN BANK; BRITISH LAND MANHATTAN EXPANSION

Ameribanc Investors Group (formerly MIW Investors of Washington) has agreed to be acquired by NCNB Corp., a major North Carolina banking company. AINVS adopted its new name in June after acquiring First American S&L of Virginia. The acquisition would give NCNB access to an extensive branch network in Washington, D.C. suburbs and Virginia's Tidewater. AINVS holders will receive 0.28 sh. of NCNB common, or about \$14.28/sh. market value. AINVS shares have moved up to \$13.50.

British Land of America has agreed

to acquire the 327,000 sq. ft. Manhattan office at 90 Broad St. from its affiliate, British Land Co. PLC, in exchange for 9.65 mil. BLA common and 3.16 mil. new BLA \$0.475 preferred convertible one-for-one into common. BLC also said it would convert a \$9.24 mil. note and exercise warrants for 4.64 mil. BLA common. The deal would give BLC 87.8% control of BLA's 21.2 mil. shs. assuming conversion of the new preferred.

Transamerica Realty Investors will be acquired for \$14.50 per share in Transamerica Corp. common, it has agreed. Transamerica already owned 40% of TAR and the previously announced offer to acquire TAR was contingent upon no better offer coming forward.

Intergroup Corp. (formerly Mutual REIT) has agreed to acquire \$110 mil.-asset Huntington S&L, Huntington Beach, Cal. via an exchange of common, the number of shares not determined.

Earnings briefs: **Radice Corp.** expects to report losing \$3.6 to \$4.2 mil. (or 60¢ to 72¢) in its June fiscal year because an expected major property sale did not close. RI builds residential and commercial properties for sale.

Pulte Home Corp. says restructuring of its Arizona homebuilding operations will cut June qtr. EPS to about 12¢ sh., from 23¢. PHM took a \$3 mil. charge for mortgage interest hedging losses in Mar.

Consolidated Capital Income Trust and **Consolidated Capital Special Trust** said they received \$12.3 mil. payments from a group of troubled borrowers under a settlement in San Francisco federal court. They previously received \$34 mil.; Income Trust now has no loans to this borrower and Special Trust has only \$7 mil. out. EPS of both trusts have been hurt by this borrower's problems.

COMPARATIVE REALTY STOCK GROUP AVERAGE 07/08/86

GROUP NUMBER & NAME	DIV	NON-DIV	TOTAL	SHARE (000)	BOOK VALUE	ANNUAL DIV	EARN ANN	LAST PRICE	-X CHANGE FROM JUN 24	JAN 1	P/E RATIO	ANNUAL YIELD	% PR TO BK	RETURN ON BK	MARKET VAL (000)	
1 PROPERTY REITS	40	5	45	5846	11.02	1.19	1.08	15.61	-0.1	8.6	14.4	7.6	41.7	9.8	4238.0	
2 PROP & MTG COMB REITS	18	2	20	5182	12.65	1.46	1.59	15.31	-1.3	-0.3	9.6	9.5	21.1	12.6	1695.5	
3 MORTGAGE REITS	14	3	17	5920	14.82	1.80	2.28	15.23	-0.1	6.8	6.7	11.8	2.7	15.4	1574.6	
4 PARTICIPATING MTG REITS	13	0	13	7855	12.40	1.23	1.21	12.91	-1.1	-0.5	10.7	9.5	4.1	9.8	1398.0	
5 MAJOR HOMEBUILDERS	8	2	10	15135	12.06	0.34	1.84	23.08	-4.1	41.5	12.5	1.5	91.3	15.3	2884.2	
6 OTHER BLDGS/DEVELOPERS	9	26	35	5538	6.00	0.15	0.20	10.26	-4.5	18.4	50.7	1.5	71.2	3.4	1958.8	
7 INCOME PROP BLDG/OWNER	15	10	25	5565	10.51	0.66	0.80	18.14	-1.2	10.5	22.7	3.7	72.6	7.6	3056.9	
8 MORTGAGE BANKER/FINANCE	10	4	14	11194	12.18	0.77	0.81	17.79	-1.8	15.4	22.0	4.3	46.1	6.7	4439.6	
9 DIVERSIFIED RLTY&HOLDING	12	9	21	22720	12.89	0.27	0.92	18.82	-1.5	19.0	20.5	1.4	45.9	7.1	14931.7	
10 RLTY SVCS/SYNDICATORS	4	2	6	8044	5.89	0.11	0.10	9.10	-8.8	-12.6	88.1	1.2	54.7	1.8	400.5	
11 MANUFACTURED HOUSING	3	6	9	12974	5.71	0.15	0.35	9.10	-12.1	-3.1	25.8	1.6	59.4	6.2	1084.2	
L LIQUIDATING COMPANIES	1	0	1	5954	2.60	0.47	-0.60	5.63	-4.3	-13.5	NC	NC	116.3	NC	33.5	
P PREFERRED STOCKS	2	0	2	1923	11.25	0.93	0.00	14.88	-0.4	13.9	NC	NC	32.2	NC	58.4	
OVERALL AVERAGE			218	8617	10.62	0.80	1.00	15.16	-2.0	11.0	15.2	5.3	42.8	7.6	37753.8	
DOW JONES INDUSTRIALS								96.43	1820.73	-2.9	17.7	18.9	3.7			
STANDARD & POOR'S 500								14.58	241.59	-2.2	14.3	16.6	3.4			
DOW JONES UTILITIES								19.40	198.23	3.8	13.4	10.2	7.5			